

## CHAPTER V

# DOMESTIC INVESTMENT

### 1. THE VOLUME OF DOMESTIC INVESTMENT

THE VALUE of gross investment in capital goods and residential buildings<sup>1</sup> in 1956 was estimated at about IL.615 million, as compared with IL.550 million in 1955. There was therefore an increase of 11–12 per cent at current prices, due to the 14 per cent rise of production costs and the 7 per cent rise in the prices of imported investment goods. The real volume of gross investment remained, however, unchanged as compared with the preceding year. Table V-1 shows gross and net investment in 1956 prices.

TABLE V-1

*Domestic Investment in Capital Goods and Residential Buildings, 1955 and 1956*  
(in IL. millions—at 1956 prices)

	<i>1955<sup>a</sup> in IL. millions</i>	<i>1956 in IL. millions</i>	<i>Change in 1956 as against 1955 in per cent</i>
Gross Investment	612	615	+ 0.5
less: Depreciation	133	150	+13.0
Net Investment	479	465	- 3.0

<sup>a</sup> Revised estimate.

SOURCE: Calculations of the Bank of Israel.

In order to obtain net investment, i.e. the augmentation of the stock of capital goods during 1956, depreciation for the replacement of worn-out equipment must be deducted from gross investment. On the assumption that depreciation is chiefly caused by the current use of capital goods, its amount during both years may be assessed at 7 per cent of the national output, i.e. IL.133 million in 1955 and IL.150 million in 1956. The real volume of net domestic investment was somewhat lower in 1956 than in the preceding year; its greater nominal value was entirely due to the higher prices of capital goods.

It must be recalled that the estimate of net investment in capital goods is not, in itself, sufficient to reflect fully the increase of the economy's production

<sup>1</sup> Excluding investment in stocks, except for government inventories, as data on stock changes are not available.

capacity during the year under review. As in former years, part of the national resources was diverted to increase labour productivity and, in particular, to the modification of the occupational structure of the recently arrived immigrants. The monetary value of such investment is not easily given to estimates and can therefore neither be counted with material assets nor be discussed within the framework of this report.

## 2. FACTORS DETERMINING THE VOLUME OF INVESTMENT

The real volume of resources available to the economy increased by 10 per cent during 1956. But as already stated, there was no increase in the real volume of domestic investment, and its share in total disposable resources fell from 17.5 per cent in 1955 to 15.5 per cent in 1956.

The decline in the proportion of resources used for investment purposes cannot be explained by the absence of investment initiative on the part of either private entrepreneurs or public bodies. At the effective rate of interest and under the conditions on which long-term investment credits from the public budgets are being granted, the generally prevailing expansionist tendencies have resulted in considerable pressure to enlarge the volume of credit for the financing of investment projects. The public bodies<sup>2</sup> were also faced with requirements for a considerable expansion of their investments in development enterprises and essential public services.

However, despite this general readiness to expand the volume of real investment beyond that of the preceding year, higher private and public consumption in fact prevented an increase of real investment, although the resources available to the economy had been larger than in 1955.

The increase of the resources available to the economy, both from the national product and from foreign capital transfers to individuals, (which had been expected income in 1956) indicated that private incomes would show a corresponding increase. In order to prevent, as far as possible, the growth of private income leading to a corresponding increase of private consumption the following measures were adopted:

(a) The fiscal burden was increased and the rise in disposable private income thereby restricted.

(b) Additional measures were introduced to encourage higher savings out of disposable private income.

Despite these measures, however, some increase in the demand for private consumption was to be expected in 1956.

On the other hand, the larger flow of capital transfers from abroad to public bodies could have been expected to manifest itself in a greater volume of resources not destined for consumption. Imports of foreign capital through private

<sup>2</sup> The Government, the Jewish Agency and local authorities.

channels become private income, much of which is spent on private consumption. However, the control exercised by public bodies over the major proportion of other capital imports should, under normal conditions, ensure a more extensive use of this additional capital for investment, once the current expenses of immigrant absorption have been financed. However, the special defence requirements which emerged in 1956 necessitated considerably higher Government expenditure and prevented the allocation to investment of some of the additional capital imports directly received by public bodies.

The anticipated increases in private consumption and Government expenditure—especially on security—confronted the Government with the choice, in its investment policy, of:

- (a) restricting the demand for capital goods within the limits of the amount of available resources residuary after maintaining the levels of private and public consumption; or—
- (b) attempting to increase the volume of investments by additional inflationary financing of the demand for capital goods.

The expansion of the demand for capital goods would not have resulted in an expansion of local production nor a reduction of unemployment (largely due to the new immigration's occupational structure, which is not adapted to local conditions) but rather in the creation of a general excess of demand and intensified pressure on the price level and the balance of payments. In the short run, a surplus demand for capital assets might possibly have increased the real volume of investment at the expense of private consumption, as price increases and the delayed payment of higher cost-of-living allowances would have reduced real personal incomes. But the experience of inflationary developments in the past induced the Government and the Bank of Israel to restrict the inflationary financing of the demand for capital goods and, as far as possible, to adjust this demand to the amount of resources which could be diverted to meet it.

The repercussions of excess demand for capital goods on the general price level were thus considerably eased, and the prices of capital goods did not rise by more than 11 to 12 per cent, despite increases in wages and world market prices.

### 3. THE FINANCING OF DEMAND FOR CAPITAL GOODS

The demand for capital goods is financed largely by funds from public budgets, mainly by the Government's Development Budget and to a smaller extent only through the issue of securities or by internal resources of private enterprises. The adjustment of effective demand to the supply of capital goods is therefore mainly effected by allocations from the Development Budget for investment purposes and by restricting the expansion of bank credit.

The financing of the demand for capital goods by public bodies is reflected by their expenditure on loans to private investors and on direct invest-

ment in public enterprises. This expenditure was estimated at IL.350 million in 1956, as compared with IL.300 million in 1955 (see table V-2). This increase roughly corresponds to the rise in the value of investments at current prices, while the share of public financing amounted in both years to 55-60 per cent of total gross investment in capital goods. The proportion of finance provided out of public sources was actually even higher, since the figures quoted do not include the finance of the demand for capital goods of enterprises owned by the Government or by public institutions, such as the Hebrew University or the Technion.

TABLE V-2  
*Estimated Investment Expenditure of Public Bodies 1955 and 1956*  
(in IL. millions—at current prices)

	1955 <sup>a</sup>	1956
Gross Domestic Investment in Capital Goods	550	615
Expenditure of Public Bodies on Investment	300	350
Percentage of Domestic Investment Financed by Public Bodies	55	57

<sup>a</sup> Revised estimate.

SOURCE: Calculations of the Bank of Israel.

Although in 1956 there was a certain decline in the weight of governmental investment expenditure within the framework of the Development Budget, while the weight of the Jewish Agency's and the local authorities' investment expenditure increased somewhat, the Development Budget still provided more than two-thirds of all public financing of investment. The Jewish Agency and the local authorities supplied the remaining third.

The demand for capital assets not financed by public bodies, which was slightly over 40 per cent of the total in both years, showed a considerable decline in the share of finance provided by foreign private investment. Investments of private foreign capital shrank from IL.27 million in 1955 to IL.13 million in 1956. These amounted in both years to less than 5 per cent of the finance of total demand for capital goods.

#### 4. GROSS INVESTMENT BY ECONOMIC SECTORS

The influential role fulfilled by the public bodies—and especially by the Government's Development Budget—is not confined to the regulation of total demand for capital goods, but enables these bodies to control the direction of investments to the various economic sectors. The funds channelled through their budgets primarily financed investments providing the basis for the develop-

ment of the economy: i.e. investments in power and waterworks or in the expansion of transport facilities and public utilities. But the other sectors too—particularly agriculture—largely depend upon these sources of public capital for the financing of their investments. Table V-3 shows the share of public financing in total gross investment, in the various economic sectors.

The influence of public bodies upon the channelling of investment to the various economic sectors is in reality far greater than shown by their share in the direct financing of the demand for capital goods. First, most of the loans to private investors are granted on the condition that the recipient invests additional funds from his own resources, thus complementing the public investment. Secondly, the Government can largely determine the destination of investments by means of direct and indirect controls. The latter include restrictions upon the import of capital goods, as well as the granting of special concessions to enterprises whose investment projects have been approved by the Investment Centre.

The considerable changes in the distribution of investments between the various economic sectors which took place in 1956 are in part the direct result of this large measure of control exercised by public bodies. Some progress was made in 1956 in the methods of evaluating the profitability—particularly with respect to the effect on the balance of payments—of investment projects whose sponsors wished to obtain Government assistance. If investments in industry (including electricity and mining), in agriculture and in transport are regarded as a first priority—in view of their favourable effect upon the balance of payments, by increasing exports or substitution of local products for imports—it can be asserted that the general structure of investment improved in 1956, because these sectors absorbed 61 per cent of total investment, as against 58 per cent in 1955.

TABLE V-3

*Estimated Share of Public Finance of Investment  
by Economic Sectors, 1956*

<i>Sector</i>	<i>Percentage of public financing</i>
Agriculture	75
Industry	30
Electricity	80
Minerals and Oil	65
Services	65
Building	35
Transport	85

SOURCE: Calculations of the Bank of Israel.

Table V-4 gives an estimate of investment in 1955 and 1956 by main economic sectors, at constant prices. More detailed information about investments in the various sectors of the economy will be found in the second part of this report, in the chapters dealing with the individual sectors concerned.

Gross investment in *Industry* continued to increase in 1956, as machinery and equipment were imported at an accelerated rate under the Reparations Agreement, and more credit was granted from Government budgets to finance investments in private industry. Investment expanded chiefly in the textile and metal branches, while in the food industry there was evidence of a tendency to decline. Gross investment in industry largely served for the replacement of worn out and obsolescent equipment in existing undertakings, but larger amounts of capital were presumably also invested in the extension of existing enterprises and the erection of new plants. Actual investments during 1956 manifested themselves mainly in the instalment of equipment ordered in the preceding years. The rise in these investments therefore permits no conclusions as to the business situation in industry in 1956 nor as to the possible existence, in the year, of expectations for a greater demand for industrial products. Nevertheless, it seems that the number of applications for the allocation of import licences for equipment, or loans from the Development Budget, did not decrease. This was probably because of the favourable conditions on which such loans are granted.

The real volume of investment in *Minerals* continued to expand, in oil drillings and the laying of the pipeline from Eilat to Beersheba, as well as in the Governmental development companies in the Negev, particularly for potash and copper.

Real investment in the expansion of the productive capacity of *Electric Power* for both industrial and domestic use grew considerably. Additional investments were made in new power stations, chiefly because security considerations necessitated the geographical dispersion of electric power production, even if extra expense was involved.

*Agriculture* showed some contraction of the real volume of investment, as a result of the reduction in new irrigation installations which had been accelerated in 1955 owing to the drought. Investment in the national and regional irrigation projects likewise declined, as the implementation of these plans received a lower priority in 1956. On the other hand, more investments were made in agricultural machinery, orchards and livestock.

In the *Transport* sector, the real volume of investments in shipping declined upon the completion of the first stage of the renewal of the merchant fleet, thus reducing the average age of vessels. However, the decline of investments in shipping is temporary, and some of the ships that will later join the fleet are already being built. Investment in civil aviation also fell off in 1956, though three new aircraft were ordered for the "El Al" Company; they will be delivered in 1957 and 1958. As against the smaller investment in sea and air transport, investments in road and rail transport were expanded with the com-

pletion of the railway line to Beersheba and the big increase in the import of lorries.

The real volume of investment in *Residential Housing* declined, mainly because of the contraction in building activities financed by public authorities. The volume of investment in residential housing was also adversely affected by the declining trend in private building, which was a result of credit restrictions and the security situation.

The real volume of investment in the *Services* contracted, chiefly because of the decline of investments in public services, which received a lower priority in the Government's Development Budget. Budgetary difficulties also limited investments of local authorities in these services. On the other hand, there was no pronounced change in the volume of investments in commerce and personal services.

TABLE V-4

*Gross Investment in the Main Economic Sectors, 1955 and 1956*  
(in IL. millions—at 1956 prices)

Sector	1955 <sup>a</sup> in IL. millions	1956 in IL. millions	1956 as compared with 1955	
			in IL. millions	in per cent
Agriculture and Irrigation	135	125	- 10.0	- 7
Industry	90	105	+15.0	+17
Minerals and Oil	23	32	+ 9.0	+39
Electricity	36	49	+13.0	+36
Transport	71	66	- 5.0	- 7
Residential Housing	194	182	-12.0	- 6
Services	63	56	- 7.0	-11
<i>Total Gross Investment in Capital Goods</i>	612	615	+ 3.0	—

<sup>a</sup> Revised estimate.

SOURCE: Calculations of the Bank of Israel.

## 5. THE COMPOSITION OF CAPITAL GOODS

The proportion of investments in machinery and equipment increased slightly in 1956 as compared with 1955, while that of investments in building and construction declined.

Two factors were mainly responsible for this change. First, it became possible to import more machinery and equipment within the framework of the Reparations Agreement, and a larger number of applications for import licences for machinery and equipment was approved (especially for industry), resulting in a corresponding increase in actual imports. Secondly, the deliberate restriction of building and construction activity reduced this sector's share of total invest-

TABLE V-5  
*Composition of Investments, by Type of Capital Goods, in 1955 and 1956*  
*(at constant prices)*

	1955		1956	
	<i>in IL.</i> <i>millions</i>	<i>in</i> <i>per cent</i>	<i>in IL.</i> <i>millions</i>	<i>in</i> <i>per cent</i>
Investments in Machinery and Equipment	200	33	230	37
Investments in Building and Construction <sup>a</sup>	412	67	385	63
<i>Total</i>	612	100	615	100

<sup>a</sup> Including all investments in agriculture other than those in machinery and equipment.  
 SOURCE: Calculations of the Bank of Israel.

ment. The orders for equipment placed during 1956, chiefly within the framework of development projects for industry and communications, indicate a rising trend in the proportion of machinery and equipment within the total volume of investment and a contraction of the share of investments in building and construction.

The relative increase of investment in machinery and equipment during 1956 was accompanied by a rise in the import of capital goods, and a decline in their local production. This contraction in the local production of capital goods exerted a certain effect upon the employment situation, especially in building and in building materials. Some of the workers discharged from these branches were absorbed by other economic sectors in the course of the year, and employed in the production of consumer goods or within the expanded framework of defence works. When evaluating the effect of investments on employment, it should be recalled that the building sector requires a large-scale participation of local production factors in the creation of capital goods, but that this sector supplies only very little employment once the capital goods created enter into current use. On the other hand, imported equipment for new industrial enterprises will require much more industrial labour as soon as the equipment begins to be operated.

## 6. INVESTMENTS IN STOCKS

The investments in stocks of raw materials, semi-finished goods and manufactures were affected by a number of conflicting tendencies operative in the economy during 1956. In some sectors, and particularly in certain branches of industry, raw material stocks were reduced, while stocks of finished goods were increased. In other sectors, such as agriculture, stocks of raw materials were

expanded. As corresponding data are not available, it is not possible to establish the general trend of the stock change during the year.

The most important changes in the stocks held by the various sectors—the basic size of which is determined by the normal requirements of the production processes—were caused by seasonal factors and by unexpected fluctuations in the supply of raw materials and the demand for finished products. The seasonal factor is characteristic of agriculture, where output and input are concentrated in certain periods of the year. Unexpected fluctuations occur in all sectors, but their importance is greatest in commerce and industry.

In industry, the expansion of real output by 9 per cent was conducive to an increase in this sector's basic inventories. Businessmen's expectations of a high level of demand only partly materialized, and inventories of finished goods therefore increased. On the other hand, industry showed a tendency, which had also been evident in 1955, to reduce stocks of raw materials. This tendency is to be ascribed both to the tight financial position and to the greater regularity of imports, which made it necessary to hold large inventories against the eventuality of import dislocations. A further cause was the higher proportion of local raw materials used in production. Increased imports of building materials, on the one hand, and the contraction of building activities on the other indicate an expansion of building material stocks in 1956. This occurred mainly in the stores of big companies and importers. Contractors apparently refrained from increasing their inventories, in view of financing difficulties, and were satisfied to purchase their current requirements of raw materials from stores as required. Stocks of cement in the factories were on the average larger in 1956 than in 1955.

Stocks of agricultural raw materials and intermediate products (e.g. grains for fodder, etc.) increased. This was due to the 16 per cent rise in agricultural output during the Hebrew year 5716 (1955/56) as a result of satisfactory harvests, the extension of the cultivated area, and the larger percentage of land under irrigation. The more widespread cultivation of industrial crops, which require the maintenance of relatively large stocks, was a further contributory factor. Stocks of finished products in this sector also increased slightly, although large stocks of agricultural finished products are not usually kept, as most of them are not durable.

The value of inventories held by the Government, the Reparations Corporation and the Jewish Agency was much greater at the end than at the beginning of 1956. These stocks increased steadily during the months January–October, and then declined.